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TAGS: [ECON](#) [EFIN](#) [ETRD](#) [ELAB](#) [PGOV](#) [CH](#)
SUBJECT: RISING PRICES, RAPID GROWTH REMAIN ECONOMIC FOCUS
DURING PARTY CONGRESS

REF: A. BEIJING 6286 AND PREVIOUS
[1](#)B. SHANGHAI 679
[1](#)C. SHANGHAI 553
[1](#)D. BEIJING 6609
[1](#)E. BEIJING 6777 AND PREVIOUS
[1](#)F. BEIJING 3895

Classified By: CLASSIFIED BY MINISTER COUNSELOR FOR ECONOMIC AFFAIRS ROBERT LUKE; REASON 1.4(B) AND (D)

Summary

[1](#)1. (C) China's most recent macroeconomic indicators showed inflation falling slightly, economic growth continuing to surge and asset prices spiraling upwards as the 17th Party Congress closed this week. Macroeconomic experts uniformly stated that recent food price pressure on the Consumer Price Index (CPI) appears to be abating, but that other inflationary trends, especially the impact of the stock and housing market bubbles on prices, potentially threaten the economy in the medium-term. In the meantime, China maintained its rapid pace of economic growth, with the GDP increasing 11.5 percent in the 3rd Quarter (year-on-year). Several contacts said they are interested to see what the combined effect of Party Congress political maneuvering, higher food prices and rapid growth will be on the rural sector. End Summary.

Consumer Prices: Headed Back Down?

[1](#)2. (U) Inflation was a chief economic concern during last week's 17th Party Congress, with government officials taking time on the sidelines of the Congress to reassure the public that the recent surge in the Consumer Price Index (CPI) may be subsiding. During separate press conferences, two Vice Chairmen from the National Development Reform Commission (NDRC) announced that consumer prices appear to be headed back down to normal levels. The CPI increased by 6.5 percent year-on-year in August -- the highest monthly rate in 11 years (Ref A) -- but NDRC Vice Chairman Chen Deming said on October 16 that the CPI had increased only 4.1 percent

year-on-year through the first nine months of 2007, and core inflation (which excludes food prices) increased by only 0.8 percent during the period. Vice Chairman Zhu Zhixin added on October 18 that the CPI's rate of growth slowed in September, hitting 6.2 percent year-on-year for the month. Zhu reassured the public that the NDRC would take additional steps if necessary, including tightening monetary policy or curbing investment, in order to maintain consumer price stability.

13. (C) Song Guoqing, a professor at Beijing University's China Center for Economic Research, told Econoff on October 21 that he believes Zhu's announcement indicates that the 6.5 percent CPI growth in August was the peak of China's consumer price inflation problem. The short-term food price inflation problem is correcting itself, Song said, as farmers increase pork production to meet demand. With lower food prices, consumer prices will become less of a concern, he said. China still will need to raise interest rates and control the growth of loans, however, to bring under control long-term inflationary pressures.

14. (C) Tang Min, Deputy Secretary General of the China Development Research Foundation, and his wife, Zuo Xiaolei, Chief Economist at Galaxy Securities, agreed that the price spike brought on by the surging demand for agricultural commodities (especially pork and eggs) may be nearly over, telling Econoffs on October 23 that the government should not be overly concerned in the short-term about intervening to stabilize prices. The government should be concerned, however, that its battle with rising prices is far from over, Tang said, as China likely will experience rising prices in the medium-term due to three primary factors:

--Rising wages due to continuing labor shortages will exert

BEIJING 00006859 002 OF 003

upward pressure on prices;

--As new local government leaders are installed, watch for unwelcome signs of trying to debut too strongly -- by spending more on vanity and white elephant projects, and by taking costly steps to please people (e.g., cutting mass transit prices, subsidies in the social sector) that in the long run would be costly and even inflationary; and

--The continuing impact of the housing and stock market bubbles on consumer prices, which potentially could be significant as the bubble grows larger and growing public confidence in asset investments affects consumer confidence, thereby pushing up prices.

The Asset Bubble: About to Burst?

15. (C) Tang and Zuo said the third point -- the impact of the asset bubbles on macroeconomic stability -- is a greater concern than consumer price inflation. Tang said the Central Government should consider pricking the stock bubble now or it may well run a long course, hitting 10,000 or 15,000. (Note: See Refs B and C for more information on the Shanghai Stock Exchange's recent surge to 5,000 and then 6,000. End Note.) If the market reaches such a high level, Tang said, a crash would cause real economic damage. Tang therefore advocates a market correction in the near-term, but he said that since it is not in anyone's political interest to be the bearer of bad news, he does not expect convincing action by the government.

16. (C) The housing market presents similar challenges, and the People's Bank of China (PBOC) and China Banking Regulatory Commission (CBRC) jointly issued new regulations in September in an attempt to curb the rise in housing prices and cool speculation in the property market (Ref D). Overheating in the housing market remains of particular concern in the provinces, as local officials continue to

promote real estate projects in order to boost their locality's GDP growth figures.

Strong 3rd Quarter as GDP Growth Remains High

¶17. (U) The national economy continued to surge in the 3rd Quarter. National Bureau of Statistics (NBS) spokesman Li Xiaochao characterized Q3 growth as "steady and fast," announcing on October 25 that China's GDP increased 11.5 percent year-on-year during Q3 following 11.9 percent in Q2 and 11.1 percent in Q1 -- an overall increase of 11.5 percent through the first nine months of the year.

¶18. (C) The 11.5 percent GDP growth figure was not surprising to our contacts. Song predicted four days before their official release that the 3rd Quarter statistics would show continued rapid growth in the economy, with a likely increase of 11 to 12 percent. Song said the Central Government is under pressure to reduce domestic investment and reduce exports in order to prevent overheating. He said that eliminating tax rebates for exporters is the best way forward as is continuing the gradual appreciation of the exchange rate.

¶19. (C) Comment: The NBS press conference originally was scheduled for October 23 but was delayed by two days, most likely so as not to interfere with, or detract from, the close of the 17th Party Congress. In addition, making the announcement on a Thursday (rather than a Tuesday) likely will mute press concerns about the economy as the media cycle hits its nadir prior to the weekend. End Comment.

Story to Watch: Impact on Rural Stability

¶10. (C) Taken together, the 17th Party Congress, food price increases and rapid economic growth combined to refocus some attention on the rural economy and rural stability. Li Guoxiang, Deputy Director at the China Academy of Social

BEIJING 00006859 003 OF 003

Sciences (CASS) Rural Development Institute, told Econoff on October 23 that the Party Congress definitely struck the right tone on rural issues with a continued focus by leaders on the urban-rural income gap and the need for providing social services in rural areas. Tang Min added that Hu Jintao's promotion of "Scientific Development," which emphasizes more balanced development, will help rural residents who may have been left behind by China's "economic growth at all costs" model. Several of our contacts, including both Li and Tang, also said that some farmers (especially pork producers) have benefited from food price increases, thereby boosting the rural economy.

¶11. (C) CASS researcher Zhang Jun, however, offered a dissenting view, complaining that many farmers have been hurt by inflation in the countryside as they pay higher prices for agricultural inputs. In addition, small farmers haven't benefited from food price increases, Zhang said, as most of those gains have been enjoyed by larger producers or the middlemen who buy from farmers and sell to the markets. Zhang also expressed concern about rapid economic growth and the impact of 11-plus percent growth, as well as the long-term goal of doubling the size of the economy, stating that China does not have sufficient resources to continue to grow at such a fast clip.

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